Dorset County Pension Fund

2019 LGPS Valuations –key issues – report by the Fund actuary

The 2019 valuations are now in full swing and there are a number of themes and issues that are emerging across all Funds including the Dorset Fund.

As ever there is some good news, some bad news and some other issues that could only be categorised as ugly.

The Good

In terms of crunching the numbers then the data is a lot better then at 2016 – the first valuation of the new CARE scheme introduced in 2014. Funds and in particular the Dorset Fund have been working hard cleaning their data.

But it's not just data is better. Funds continued to achieve strong positive asset returns in the 3 years to March 2019. Some quite considerable variation though with returns ranging from about 8% p.a. to 12% p.a. The Dorset Fund return was around 11% per annum.

So any other good news?

As has been widely reported there has been a slowdown in the rate of improvement in longevity. This might not sound like good news but it is for some - undertakers and pension funds are the more obvious benefactors. With the help of our longevity team we have been analysing the mortality experience of our LGPS Funds including the Dorset Fund. So as at 2019 mortality rates are generally higher than we were projecting back in 2016 and future projections have also been scaled back. Mortality is still improving – we are all still living longer – but maybe not just as long as previously thought. So Funds are now projected to pay out less pension benefits than previously thought.

The Bad

Of course it's never all good news.

The slowdown in longevity improvements will lead to less being paid out than before. However forward projections of inflation have increased meaning more expected to get paid out than before. Overall one probably cancels out the other.

Strong positive asset returns are of course great – provided you had some assets at the start. Not so great if you still need to buy some – much more expensive than before means we need more cash to buy the same assets. It's a bit like the property market – mums and dads feeling a bit wealthier as property prices increase but the kids looking to buy needing more cash to get on the property ladder.

LGPS Funds are of course still accruing new liabilities and need to buy new assets to fund these liabilities. So this means we need more cash to buy these more expensive assets to meet these new liabilities. This all gets reflected in the determination of those discount rates that everyone loves but never really understands. So the biggest part of most employers' contributions – the so called "primary rate" – the cost of future accrual has increased albeit not as much as it might have done thanks to the slowdown in longevity improvements.

So overall how does it all stack up?

Funding levels will be up – as expected but are likely to be quite a bit higher than expected – the extra asset returns and longevity changes will have outpaced the increase in inflation and lower discount rates. In the Dorset Fund the funding level has increased from 83% to 92% with the deficit reducing from £452m to £255m.

So higher funding levels usually means lower deficits and reductions in deficit contributions.

However primary rates have increased thanks to higher inflation, lower future return expectations as reflected in discount rates net of the longevity expectations. For the Dorset Fund the average primary rate has increased from15.6% to 17.7% of pay.

So when we add it all together where are we and will we see any reduction in employers' total contributions?

It's a question we get all the time – what does it take to actually reduce employer contributions? It's a simple question with a not so simple answer. As ever – it depends on a number of factors. Funding level does come into it but so too does the existing level of contribution.

In the long term the cost of the LGPS to employers is probably somewhere in region the 15% to 20% of pay.

So a Fund with a 102% funding level with employers paying 18% of pay – a reduction is unlikely as it wouldn't take much to get back into negative territory and a not insignificant risk of having to increase contributions at the next valuation having just reduced them. A Fund on a funding level of 98% with employers paying 35% of pay – a very modest reduction is more likely as still might be okay in 3 years' time even if funding levels decline.

The ugly

The ugly stuff is mainly the regulatory uncertainty – the well intentioned if flawed and now paused cost management process, section 13 valuations and of course the McCloud case. Of all the assumptions actuaries have to make the outcomes of these are probably some of the most challenging as they are more political and legal in nature and so more difficult to predict.

Once the valuations are all put to bed and we reflect back on the financial status of the LGPS and in particular the Dorset Fund at the 2019 valuations the conclusion will be that the LGPS is in a pretty good place. More assets than ever – but equally more liabilities than ever - but the gap between the two closing. The challenge is that the cost of funding new liabilities has increased but overall the total cost of past and future liabilities across the LGPS should be relatively stable. This will not of course be the case for all of the 16,000 employers in the LGPS but will be for many.

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